

Sustainability Analysis Update

January 16, 2009

During the first six months of fiscal 2009 revenues dropped by nearly 4.4% over the same period a year ago. The FTF sustainability analysis assumed the historical average drop in tobacco revenue of 1.4% per year. Evidently the recession, slower population growth for Arizona, campaigns to reduce smoking and relatively high taxes on tobacco products is having a bigger impact than was shown last year. The financial markets are also suffering and return on our investments has been reduced from about 5% a year ago to just above 2% for December, 2008. Given these factors, a review of the sustainability of FTF programs and services over the next decade is prudent. Also prudent would be to look at some adjustments in expected future funds management to compensate for potentially lower revenues. We are not recommending any changes at this time, just continuing to monitor and being ready to make recommendations in the future if recent trends continue. We have one possible scenario to look at as an example of the kinds of things we might do.

Tobacco Tax and Investment Revenue Chart

The **chart on page 2** of the power point shows monthly year-over- year tobacco tax and investment revenue for FY 2008 and FY 2009 through December 31, 2008 (the first half of FY 2009). With the exception of July 2008 (the first month of FY 2009), monthly revenues in FY 2008 were higher than revenues for the first six months of FY 2009. The average monthly revenue year- to-date is approximately \$13.1 compared to over \$13.7 million last year. This is approximately 4.4% lower than the monthly average throughout FY 2008. The decline in revenue is due to a number of contributing factors.

Key Assumptions Chart

The **matrix on page 3** of the power point shows the key assumptions previously used to develop the sustainability analysis, the revised assumptions and a set of alternative assumptions. The revised assumptions are conservative for the remainder of this fiscal year, reflecting a monthly average of \$12.8 million in revenue compared to the \$13.1 million average for the first six months.

Sustainability Analysis Chart- Previous vs. Revised Projections

The **chart on page 4** shows the sustainability based on the following assumptions:

- 1) Previous 4% annual growth for program spending (no revision)
- 2) Previously 3% annual growth for administration spending (no revision)

- 3) Previously a 1.4% annual decline in tobacco revenue (revised to reflect \$12.8 million average monthly revenues for the remainder of FY 2009 and then 2% decline thereafter)
- 4) 2% average annual yields on investments starting in FY 2011 (no revision made)
- 5) Distribution 90% of investment earnings to Program Account (no revision)

As depicted in the chart on page 4 of the power point we previously projected that funds would be available through the start of FY 2020. Based on the revised assumptions stated above, we project that funds could be depleted shortly after the start of FY 2018. The fund balance based on the previous assumptions is depicted by the purple descending arch and the fund balance based on the revised assumptions is identified by the green descending arch.

Sustainability Analysis Chart- Previous vs. Alternative Projections

The **chart on page 5** shows the sustainability based on the following assumptions:


- 1) 3% rather than 4% annual growth for program spending
- 2) 2% rather than 3% annual growth for administration spending
- 3) 2% rather than the 1.4% annual decline in tobacco revenues (and \$12.8 million monthly estimated for the remainder of FY 09)
- 4) Continue to reflect 2% average annual yields on investments
- 5) 90% of investment earnings will continue to go to programs

By lowering annual increases in both program and administrative funding, sustained funding for FTF programs and supports would continue for an additional fiscal year until 2019, approximately one year longer than under less restrictive revised assumptions scenario shown on page 4. The fund balance based on the previous assumptions is depicted by the purple declining arch and the fund balance based on the alternate assumptions is identified by the green declining arch.

It is intended that we revisit the revenue trends and sustainability analysis one more time prior to finalization of any FY 2010 budget adjustments in May or June of this year.

1/15/09

dtjo

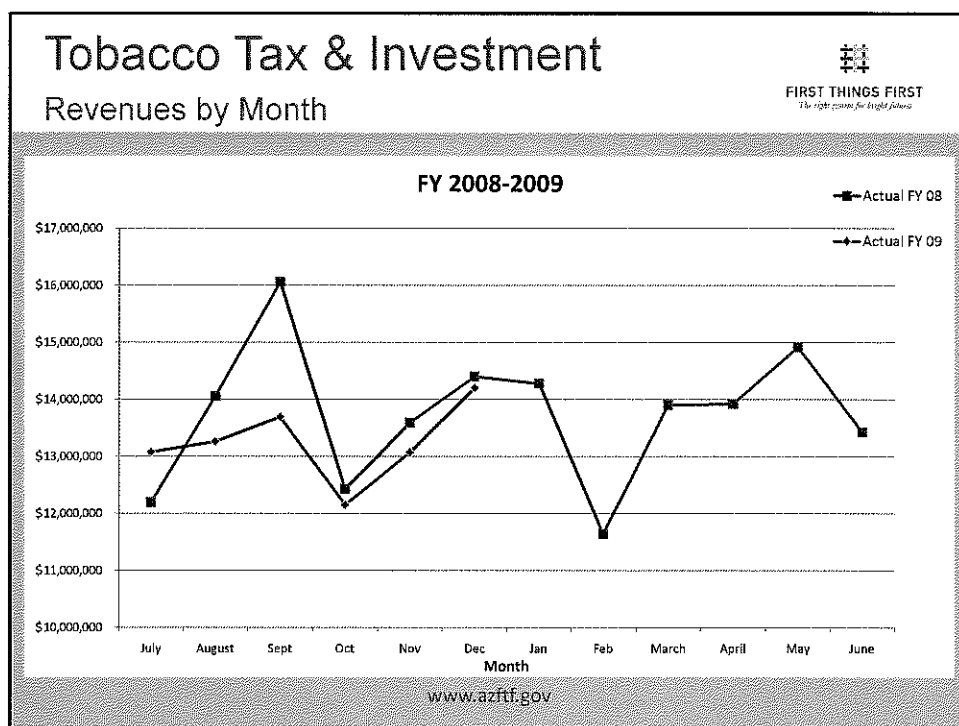

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SUSTAINABILITY UPDATE

Sustainability Analysis--Revisited

January 16, 2009

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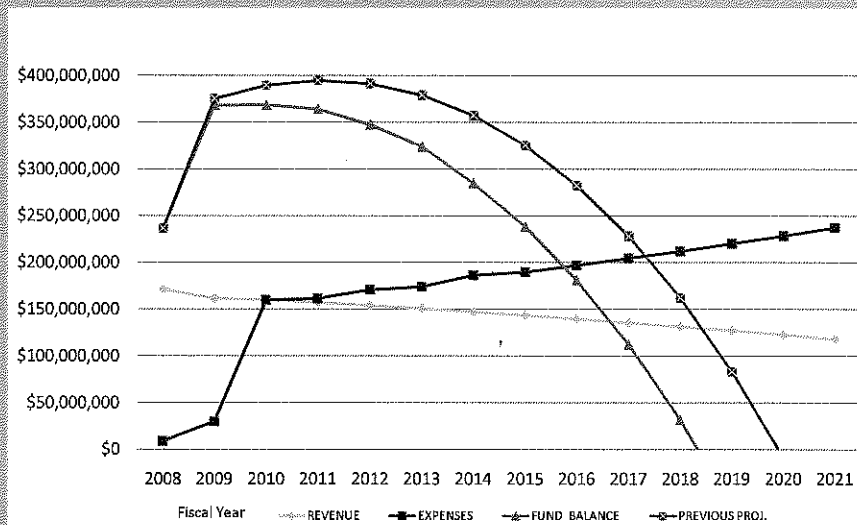
Sustainability Analysis Update Through December 2008			
Key Assumptions			
	Previous	Revised	Alternative
Programmatic Expenditure Increase	4%	4%	3%
Administrative Expenditure Increase	3%	3% plus additional \$550,000 increase in FY 2010	2% plus additional \$550,000 increase in FY 2010
Tobacco Revenue Decline	1.4%	2% (\$12.8M monthly est. for remainder of FY2009)	2% (\$12.8M monthly est. for remainder of FY2009)
Average Return on Investment	2.00%	2.00%	2.00%
Investment Earnings Distribution	90 % Programs 10% Administration	90 % Programs 10% Administration	90 % Programs 10% Administration
Staff Pay Raises	Excluded	Excluded	Excluded
Note Changes from previous scenario are highlighted in yellow.			
FY2009 Revenue & Expenditure Summary Historical Financial Statements			

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Sustainability Analysis

Previous vs. Revised Projections

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